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Whither the World Bank and the IMF?

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1. *Introduction*

THE WORLD BANK AND IMF were founded just over a half century ago.[2] Since then, the world and the international financial institutions (IFIs) have changed markedly. Their original rationale no longer fits, and their activities have altered as the world economy has grown. The occasion of their anniversary saw an outpouring of opinions and material on the past and present performance of the IFIs, and the role they might play in the future. Analyses of their activities and appropriate role have intensified in the wake of the Mexican peso crisis at the end of 1994 and the Asian crisis in the summer of 1997. It is the purpose of this paper to provide a selective review of the Bank and Fund's current roles and the choices that confront them for the future.

To do that, a preliminary section covers the roles the IFIs were intended to play and the roles they in fact played in the highly successful evolution of the international economy over the half century after Bretton Woods. Attention then turns to their current roles, their successes and failures, and the changed international economy. Finally comes the question of their future functions.

To summarize the argument briefly, in the first quarter-century of their existence, the IFIs performed well and earned their standing in the international economy. While mistakes were made, the IFIs were generally following, and sometimes contributing to, the "best thinking" on the relevant issues, and learning from experience.

The IFIs then adapted their activities and policies as understanding of some of the underlying issues improved, and as the international economy changed. By the 1980s, those adaptations resulted in considerable overlap as the two institutions focussed on much the same issues of economic policy reform

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[2] A good argument can be made that the General Agreement on Tariffs and Trade (GATT), now the World Trade Organization (WTO), has been at least as effective, judging by the liberalization of trade during the half century. However, until the formation of the WTO, the GATT did not have the status of a formal international organization. I shall refer to the Bank and the Fund together as the IFIs (international financial institutions) or Bretton Woods institutions, and to the Bank, Fund, and WTO together as the three international organizations.

for economies in transition and for developing countries. With the transformation of some developing countries to "newly industrialized" status and greatly increased private capital mobility, many questions arise as to what the future role of these institutions should be.

With regard to the World Bank, many countries have successfully developed to the point where national governments are fully capable of either carrying out project design or of contracting for design and construction to private institutions. There is a strong argument, therefore, that in the future the Bank should increasingly focus on the remaining very poor countries of the world: most of Subsaharan Africa, significant parts of Central and South Asia, and some countries in the rest of the world. The alternative—which the Bank seems currently to be following—is to take on the "soft issues" that are not thought to receive adequate emphasis by national governments or by private markets.

The important issues regarding the IMF concern the ways in which Fund programs can contribute in a world with very high private capital mobility, where private funds are a large multiple of Fund resources. In particular, the issue of "crisis management" is critical. Related to that, there are significant issues as to the Fund's role in structural reforms, and its relationship to the World Bank in that regard.

2. *The Original Rationale and Activities of the IFIs*[3]

2.1 *Rationale*

The conception of the international economy on which the postwar system was premised was largely born out of the experience and apparent lessons of the Great Depression.[4] The IMF was founded in the expectation that it would serve as the guardian of a system of "fixed, but adjustable" exchange rates to prevent "beggar-thy-neighbor" trade policies and competitive devaluations that were believed to have contributed significantly to the length and severity of the depression.[5]

It was also thought that the private international capital market had been destroyed by the Great Depression, and that official capital flows would be needed to permit efficient allocation of resources toward countries with high rates of return to investment and low savings rates—primarily countries undergoing reconstruction and low-income countries undertaking development. The International Bank for Reconstruction and Development[6] (IBRD) was therefore established as a sister institution to the IMF to meet this perceived need.[7] It is important to recognize that, while the IMF's articles enshrine the desirability of current

[3] The reader interested in more detailed background regarding the founding of the IFIs can consult Richard N. Gardner (1969).

[4] See Anne Krueger (1997b) for an examination of the factors influencing decisions at Bretton Woods. Peter Kenen (1985, pp. 628–36) gives an account of the "stylized facts" underpinning Bretton Woods.

[5] Subsequent research has questioned the extent to which competitive devaluations and erection of higher trade barriers did in fact contribute. See Barry Eichengreen and Jeffrey Sachs (1985).

[6] The IBRD subsequently became one part of the World Bank Group which also includes the International Development Association (which lends on concessional terms to poor countries but whose staff is the same as the IBRD's); the International Finance Corporation (the arm of the Bank assigned the task of lending to the private sector); and several smaller institutions providing investment guarantees and investment dispute settlement procedures.

[7] There was also a planned International Trade Organization, to avoid beggar-thy-neighbor tariff increases, and to facilitate the mutual reduction of tariff levels. Since the ITO was never ratified, that part of the story is omitted here. It should be borne in mind, however, that by any measure, success in trade liberalization was a highlight of the postwar era. See Krueger (1998) for a history.

account convertibility and free trade, the presumption of the Bretton Woods *architects* was that private capital markets (at least long-term ones) had been effectively destroyed during the Great Depression. Indeed, in Keynes' proposal, the Fund would have been able to require countries to impose capital controls, and even the U.S. Treasury seems to have envisaged only short-term trade-related finance (see James Boughton, forthcoming).

2.2 *Early Role and Activities: The IMF*

Countries experiencing balance of payments difficulties were expected to approach the Fund: if difficulties were deemed temporary, they could borrow,[8] and if difficulties were thought to be fundamental, an exchange rate change would be approved. Borrowing was/is subject to increasingly stringent oversight or conditions (which is where the term "conditionality" comes from) as its magnitude increases. Stand-by arrangements are usually associated with upper tranche borrowing. They stipulate performance criteria and are normally disbursed in intervals over a one- to two-year period. Fund lending was and is at near-market interest rates and normally repayable in three to five years.[9]

Contrary to expectations at Bretton Woods that the IMF would have to prevent countries from devaluing their currencies, in practice the Bretton Woods system almost immediately became a virtual fixed exchange-rate system, or as Ronald McKinnon has termed it, the Fixed-Rate Dollar Standard.[10] If foreign exchange reserves were being rapidly depleted in defense of a nominal exchange rate that had been fixed for substantial periods despite domestic inflation, countries approached the Fund for assistance. Fund support was usually forthcoming only after a "stabilization program" was agreed upon.

Programs typically included adjustment of the nominal exchange rate (to a new, fixed parity) and fiscal adjustment. The Fund normally focussed its "conditionality" on the size of the fiscal deficit, domestic credit, and other macroeconomic "intermediate target" variables. Rationalization of the trade regime and capital controls, removal of ceilings on interest rates, and other reforms have also been part of Fund programs. By and large, information regarding conditionality in Fund lending and annual consultations was not publicly reported. Fund staff documents were and are released only if the country under discussion agrees to publication. This lack of transparency (which, at least to a degree, is surely necessary when issues such as exchange rate policy are discussed) has been a source of criticism of Fund (and, to a lesser degree, Bank) activities. In recent years, the Fund and Bank have attempted to increase transparency: the Fund now

[8] Initial financing of the Fund (and the IBRD) came from members' paid-in capital. Payments were made partly in gold, partly in convertible currencies and partly in own currencies. Members could then seek to borrow from the Fund in "tranches", which were in proportion to their capital subscriptions. Access to a first tranche was and is virtually automatic, since it is equal to the gold proportion of paid-in capital.

[9] See Alisdair MacBean and P. Nicholas Snowden (1981) and IMF (1994) for more details. While the interest rates on Fund lending are "near-market", the borrowers usually would not be able to borrow at those rates at times when they approach the Fund.

In the 1980s, new "windows" were opened under which the poorest countries could borrow for longer time periods.

[10] See Ronald McKinnon (1993, p. 16). I happened to visit a high official of the IMF the day after he returned from negotiating the British devaluation of 1967. He had also been a delegate at Bretton Woods. He commented that, at the conclusion of the Bretton Woods conference, the first toast had been "to the end of competitive devaluations; little did I dream that I would spend the rest of my life persuading countries to devalue."

places standby arrangements on the web shortly after an agreement is approved by its board.

Negotiations leading up to agreement on a Fund program can be somewhat adversarial in nature, especially when the motive for seeking Fund support is more to obtain quick foreign exchange to finance imports than to reform the underlying economic policy stance. Moreover, since balance of payments difficulties are normally symptomatic of unsustainable levels of expenditure relative to income, the conditions negotiated in Fund programs often result in at least a temporary retardation in the rate of economic growth, if not a recession. Because of this, Fund programs have often been subject to political attack.

Even in the 1950s, there were Fund programs in developing countries, Argentina and Peru prominent among them (see Ernest Sturc 1968). The first large-scale activity involving developed countries took place in 1956 and 1957 when Britain and France both sought support in the aftermath of the Suez crisis. Until the 1970s, the Fund continued to support exchange-rate alterations in developed countries, including the U.K. devaluation of 1967.

From the Fund's earliest days, the research department contributed importantly to understanding of balance of payments difficulties and adjustments. Indeed, the work of Jacques Polak, Sydney Alexander, and later of Robert Mundell, Marcus Fleming, and others, undertaken in the Fund's research department, was pathbreaking, and is widely cited as a forerunner to the monetary approach to the balance of payments of the 1970s.[11]

By the late 1960s, few questioned the usefulness of the Fund's role in the fixed-but-adjustable exchange rate system, but many analysts were questioning the wisdom of the fixed exchange-rate system itself.[12] Difficulties were seen in the increasing rigidity of exchange rates and the emergence of a de factor dollar-exchange standard with the asymmetric pressures it placed on deficit and surplus countries. Concerns about the latter led to the adoption of the proposals for having the IMF provide additional world liquidity through the issuance of Special Drawing Rights (SDRs), but little came of that after the burst of worldwide inflation in the early 1970s. By 1973, fixed exchange rates were abandoned, and the Fund lost much of its original rationale. Thereafter, the Fund's activities related, and were seen to relate, almost exclusively to developing countries; the macroeconomic imbalances resulting from the oil price increase of 1973–74 gave the Fund a new focus almost immediately, especially for oil-importing developing countries.

2.3 *The World Bank as a Project Lending Institution*[13]

The IBRD was to be a financial intermediary providing long-term finance for productive projects, initially primarily for reconstruction purposes. It was empowered either to borrow in private

[11] See Kenen (1985, p. 669). See also Mario Blejer, Mohsin Khan and Paul Masson (1995) and Jacques Polak (1995) for histories of the Fund's research program.

[12] Robert Triffin (1957) was among the first to raise questions and strongly criticized the Fund as incapable of handling the emerging issues associated with the system. See Harold James (1996), pp. 155ff for an account. Of course, Milton Friedman's (1953) classic paper had already put forth the case for flexible exchange rates.

[13] The IBRD/World Bank has always regarded itself as a development institution. Its activities are analyzed in that light in this paper. Considerations pertaining to humanitarian aid—provision of means to extend immediate assistance of food, shelter and other aspects of living standards in the short run—are not discussed.

capital markets and then lend or to guarantee loans made directly by private creditors. In practice, the IBRD has lent, and made little use of its guarantee powers.

While the resources of the IBRD paled in contrast to those of the U.S. government under the Marshall Plan, it made a number of reconstruction loans in the late 1940s and early 1950s.[14] However, as postwar recovery continued, the IBRD increasingly undertook project lending to developing countries. All its lending until 1960 was on commercial or near-commercial terms. By 1960, it had become clear that some very poor countries could borrow very little at these terms, and the International Development Association (IDA) was established[15] to provide "soft loans" to poor countries. It was financed by "replenishments" every three years from industrialized countries. Collectively, the IBRD, IDA, and related institutions became known as the World Bank.[16]

As the World Bank gained experience, its research and its practices enabled it to become a provider of technical assistance as well as of capital. It is often forgotten how limited institutions and government staffing were in developing countries in the early days of independence. In many cases, ministers had little or no experience, ministries were staffed with people with few credentials, and governments themselves were operating under new constitutions and institutional arrangements.[17] World Bank standards for formulating and executing projects, as well as for policies pricing outputs of power and other projects, were valuable in improving the quality of projects carried out under their auspices, and there was considerable spillover to other projects.[18]

There are several indicators of the standing of the World Bank in its first quarter century. First, by the early 1970s, the U.S.—which was then the dominant (bilateral) provider of foreign aid to developing countries—decided to rely more on the World Bank and reduced its own staff for foreign aid significantly. Indeed, until the early 1980s, Bank lending and IDA credits were increasing in relative and absolute importance as a source of development finance. Second, regional development banks were established, modeled closely on the World Bank. These include the Asian Development Bank, the Inter-American Development Bank, and the African Development Bank.[19]

In contrast to the Fund's programs, Bank project lending carries fewer

[14] The U.S. extended $6.2 billion to European countries under the Marshall Plan in 1948–49, $4.1 billion in 1949–50, and $2.4 billion in 1950–51. The IBRD's lending to Europe was less than $1 billion during the reconstruction period. The Fund lent about $125 million to France but was basically excluded from European operations because of disagreement between the U.S. and U.K. over dismantling exchange controls. See James (1996, p. 74) for details.

[15] See Krueger (1986) for an elaboration of the rationale for providing credits to poor countries on concessional terms.

[16] The International Finance Corporation (IFC) was established in 1956 to lend to the private sector. Its activities were overshadowed by those of the IBRD and IDA until the 1990s, when IFC lending increased significantly. This is discussed further below. Other parts of the World Bank include The International Center for the Settlement of Investment Disputes (ICSID) and the Multilateral Investment Guarantee Agency (MIGA).

[17] Wolfgang Stolper (1969) provides an illuminating discussion of some of the challenges for the Nigerian case.

[18] See Edward Mason and Robert Asher (1973). Bank insistence upon cost-benefit analysis and project appraisal was not only important for Bank projects, but was probably instrumental in embedding these techniques in borrowing governments' practices with regard to domestically-financed investments.

[19] There are also a large number of official lending institutions for smaller geographic groupings.

negative overtones, although insistence upon price increases or imposition of user charges as a precondition to lending for infrastructure has increased in recent years.[20] Ministers of agriculture, energy, transport, and other sectoral domains are normally pleased to have financing to undertake additional projects. Negotiations leading up to a project normally entail technical collaboration between, e.g., officials in the Ministry of Agriculture responsible for irrigation and IBRD technical staff, which is inherently less confrontational than IMF negotiations.[21]

Whereas the Fund typically has an active program only for countries with payments difficulties, the World Bank has ongoing operations and interests in a large number of countries, since most eligible borrowers are continuously seeking to develop new projects. Bank staff have historically regarded themselves and been regarded by most as "friends of developing countries."

3. *1973–77: Post Bretton Woods*

3.1 *Response to the First Oil Price Increase*

Following the demise of the fixed exchange-rate system, the two oil price increases, the worldwide recession of the early 1980s,[22] and accumulated problems from ill-advised domestic economic policies, many developing countries experienced severe payment imbalances, high and rising rates of inflation, and sharp drops in growth rates.[23] It was natural for countries to approach the IMF and for IMF staff to concentrate their attentions on these macroeconomic imbalances.[24]

Meanwhile, although the World Bank essentially continued its project-lending mode during the 1970s, as experience mounted, it became increasingly evident that the success of individual projects was crucially dependent on the overall economic policy environment.

Even in the late 1970s, it was probably a safe generalization that the Fund concerned itself with macroeconomic policies in developing countries (including exchange rates, trade regimes, and financial markets) while the Bank was lending or extending credits for microeconomic and infrastructure investments.

[20] See Robert Holt and Terry Roe (1993) for an interesting account of the effectiveness of program aid in the case of Egypt.

[21] This is not to say that there cannot be differences over issues such as the size of the project, the pricing policies to be pursued for energy, water or power, and the degree to which maintenance work will be undertaken by the borrowing government. But if disagreements are serious, the Bank can always move along to another project, whereas Fund issues cannot be avoided and the fundamental need to reduce excess demand often places the Fund in an adversarial position. Moreover, for most of its history, a key performance indicator for Bank staff has been the volume of lending. As such, Bank staff often have as much interest in reaching agreement on a loan as do recipients.

[22] After the first oil price increase, many developing countries were able to borrow, normally at fixed nominal rates of interest, from private international capital markets. For the most part, the borrowers were able to maintain debt-servicing obligations because of the increase in the prices of their exports that accompanied the worldwide inflation of the late 1970s, and there was no significant increase in the closely-watched debt-export ratio.

[23] Most developing countries at that time invoked the balance of payments clauses in the GATT articles to rely on quantitative restrictions to contain imports. They maintained fixed nominal exchange rates in the face of domestic inflation for extended periods of time, and import licensing became increasingly restrictive. When these oil-importing developing countries were then confronted with the increased price of oil, the impact was severe.

[24] There are annual "consultations" between Fund staff and the relevant economics teams in individual countries, both developed and developing. Fund staff can, of course, express unease at a country's policies, and warn of the likelihood of future difficulties if action is not taken. However, these admonitions are taken much more seriously in situations where financing is, or may be, sought.

Criticisms of the two institutions diverged at that time because of these roles. On the one hand, most critiques of the Fund centered on its "conditionality," or set of conditions under which it would lend, as being too "harsh."[25] By contrast, the Bank was seen as being "too friendly" to developing countries and insufficiently critical of their policy framework while occasionally lending in support of ill-advised projects.[26]

With the second oil price increase, Bank policy began to change with the beginning of "Structural Adjustment Lending" (SAL).[27] This represented a significant departure from earlier project finance, as SALs and SECALs, like Fund loans, essentially provided rapidly-disbursing foreign exchange to support policy reforms.[28] Even when SALs and SECALs were most important, however, the Bank remained predominantly a project lending institution, with less than a quarter of its new lending, and much less than that of its portfolio, consisting of SALs and SECALs.

During the debt crisis of the early 1980s, the Bank intensified its focus on developing countries' economic policies, as it was recognized that severe macroeconomic imbalances were detrimental to growth prospects and as the contrast between the performance of East Asian countries and, especially, Latin American countries became stark.[29] At the same time, the Fund expanded the range of economic policies it included in its programs, moving well beyond the traditional measures of demand restraint that it earlier negotiated, and including more "supply-side" measures in its programs. After the first oil price increase, it had already established facilities for lending beyond its normal term,[30] and use of these facilities increased greatly. With all of this, the Fund was moving toward domains that had earlier been almost exclusively the Bank's, while the Bank, in moving toward program lending, was moving to incorporate some of the traditional concerns of the Fund.

By the late 1980s, some of the problems associated with the overlapping domains of the Bank and the Fund became evident. In perhaps the most famous instance, the Bank, under strong pressure from the U.S., continued lending to Argentina while the Fund withheld support based upon its more pessimistic view of Argentina's macroeconomic policies (see James 1996, pp. 375–79).

After the inconsistency of these two decisions became evident, the executive boards of the two bodies decided to ask for joint papers from the staff of the two institutions analyzing the policy stance of each developing country with which both dealt. These papers were approved by the boards of the two institutions, and then became the basis for lending by either. Also, after the fall of the Berlin Wall, each IFI increased staff work on transition issues, shifting

[25] See Manuel Guitian (1995) for a discussion of Fund conditionality.

[26] The Bank lent in support of tourism, building steel mills in the public sector, and a variety of other industrial ventures that would today be judged to be inappropriate for governments. For more particulars on the Bank's lending program, see Mason and Asher (1973), and the *Annual Reports* of the Bank.

[27] The Bank also began "Sectoral Adjustment Loans", or SECALS, where it was deemed that officials were not prepared to undertake economy-wide reforms, but were willing to change practices significantly in a particular sector such as trade, finance, or agriculture.

[28] See Ernest Stern (1983) for a very good statement of the initial rationale for Structural Adjustment Lending.

[29] For an overview of this contrast at the time, see Sachs (1985).

[30] Fund lending was often for one year, and then renewed. But repayment terms were generally three to five years.

some staff from earlier assignments and recruiting for the purpose.

By 1997, the Bank was moving away from SALs and SECALs to project lending, but with emphasis on the "soft issues," such as environment, women's role, and linkages with nongovernmental organizations (NGOs). Meanwhile, Mexico had experienced the peso crisis in 1994, and Thailand, Indonesia, Malaysia, and South Korea all encountered major macroeconomic crises in 1997. Issues of the Bank's role with respect to middle-income countries and of the Fund's role in crisis management are central to consideration of their future paths, and are considered in Section 4 below.

Here, one other trend should be noted. Starting in the 1980s, the IFC began assuming a more prominent role. Whereas it had played a very minor role in the Bank Group's activities in earlier years, the IFC in the 1980s began aggressively seeking to support private sector activities; its overall level of lending has grown at an average annual rate of about 16 percent over the past decade, and in 1997 its net disbursements were \$1.7 billion, in contrast to the Bank's \$2.1 billion.[31]

3.2 *Evaluation of Fund and Bank Lending and Effectiveness*

It is inherently difficult to evaluate the impact of either Fund or Bank lending on the overall economic performance of the borrowers.[32] Each IFI lends in amounts that are a relatively small fraction of aggregate investment, and thus could not be expected to contribute greatly to the overall growth rate simply through increasing investment. Moreover, Fund programs are normally undertaken when the borrowing country is facing serious economic difficulties; asking the counterfactual of what would have happened in the absence of Fund support may be the crucial question, yet it is difficult to answer. Those countries not undertaking Fund programs are surely not an appropriate control group.

For the World Bank, the same considerations apply to analysis of Structural Adjustment Lending. For project lending, assessing the impact on developing countries' growth is problematic in light of the relatively small fraction of investment (under 2 percent[33]) in developing countries financed by the Bank, and, of course, the fact that money is fungible. Hence, even if Bank lending shows a satisfactory real rate of return (which it historically has), it can always be argued that: a) the project in question would have been financed from domestic resources and the funds released would then be used on a project with a low rate of return; and/or b) Bank-financed projects are so well funded that they draw the "best and the brightest" of domestic resources to them, and their own high rates of return come at the expense of lower rates of return for domestically funded projects. A contrary consideration is that Bank support in project preparation probably provided "on the job training" for nationals in borrowing countries that improved their capacity to develop future projects.

Nonetheless, it is easier to evaluate the outcome of project lending than of Fund programs or Bank SALs and SECALs. The Bank reports on returns

[31] In 1985, IBRD disbursements were \$5.3 billion, while the IFC's were \$0.3 billion. Data are from World Bank and IFC *Annual Reports,* 1985 and 1997. See William Ryrie (1995) for an account of IFC's evolution after the early 1980s.

[32] I use the term "lending" here to cover all IMF and World Bank programs, including IDA credits.

[33] The sole exception is Sub-Saharan Africa where the Bank has funded a significant fraction of investment for a large number of countries.

TABLE 1
MAGNITUDES OF WORLD BANK AND PRIVATE CAPITAL FLOWS TO DEVELOPING COUNTRIES
1970, 1980, 1985, AND 1990s
(BILLIONS OF U.S. DOLLARS)

	1970	1980	1985	1990	1991	1992	1993	1994	1995	1996
Total Net Flows	11	86	63	101	123	146	212	207	237	285
IBRD	.5	3.2	5.3	5.5	2.1	1.8	2.3	–.7	1.4	1.7
IDA	.2	1.6	2.8	4.2	4.3	4.4	4.6	5.1	5.0	5.6
Net Private Flows	6	52	28	44	57	91	157	161	184	244

Sources: World Bank, *Global Development Finance 1997;* World Bank, *World Debt Tables 1992–93.*
Note: 1996 data are preliminary.

on its own projects. In real terms, the mean rate of return has exceeded 10 percent.[34] Indeed, Arnold Harberger (1972) has defended World Bank lending on the grounds that real returns have been well above those that might more generally have been expected.

While the realized real rate of return on Bank projects has fallen somewhat over time,[35] there are few criticisms of the real returns on project lending.[36] The critical issue that arises is whether future Bank project lending is warranted, especially in middle-income countries where private capital seems fairly readily available, and where nationals of the countries are well qualified to undertake project preparation and design. We return to this question when assessing the future of the two institutions.

Bank project lending was the bulk of its activities even in the heyday of SALs and SECALs, and once again accounts for over four-fifths of all Bank lending and credits. Regardless of how high a rate of return there is on Bank project lending, the increasing importance of private capital flows relative to official flows is clear. Table 1 gives data. As can be seen, in 1970, official flows (including bilateral aid, not listed explicitly in the table) constituted almost half of net capital flows to developing countries, and IBRD and IDA funds constituted about a fifth of official assistance. By the mid 1990s, however, all official flows were less than one sixth of total flows, and while IBRD and IDA funds constituted about the same fraction of official flows, their importance relative to total flows had diminished commensurately: only $7.3 billion originated with IBRD and IDA, while private flows were $244 billion.

These figures, of course, mask significant variation between countries. For

[34] As already mentioned, there is no question that some earlier Bank lending, directed toward manufacturing investments and state-owned enterprises, was ill-advised. Most of those activities had ceased by the 1980s.

[35] An increasing number of critics have criticized the Bank on the grounds that, since it lends to governments, it must be strengthening governments. See the discussion of criticisms of the Bank, below.

[36] There are critics who claim that Bank lending was insufficiently sensitive to environmental issues. In recent years, however, the Bank has emphasized these concerns. One can argue that, in poor countries, the relative importance attached to environmental concerns is naturally less than in rich countries (just as the now-industrialized countries paid much less attention to environmental issues in the last century). Experience with the more "environmentally-friendly" lending posture of the bank is probably too recent to permit an assessment of whether the new emphasis on environmental concerns has achieved the appropriate trade-off for poor countries.

some Sub-Saharan African countries, official flows can constitute the majority of all capital inflows, and IDA resources can themselves represent a significant fraction of that total. Nonetheless, the fact remains that, contrary to the vision of the Bretton Woods participants, private international capital markets have resumed, and for many (especially middle-income) developing countries dwarf the lending and credits of IBRD and IDA. Clearly, the Bank no longer plays a major role in financing official capital flows for many developing countries, and its role in that regard—project or program lending—needs rethinking.

Turning then to program lending, Guitian (1981) suggested three criteria for evaluation of Fund programs, and those criteria could apply with equal justification and limitation to Bank SALs. They are: 1) a comparison of the value of key parameters before and after a program; 2) a comparison of the program's targets to the actual outcome; and 3) a comparison of the actual outcome to what might have happened under an alternative program.[37]

Each of these alternatives is subject to obvious difficulties. The third is perhaps closest to the ideal for evaluation, but developing a robust model to estimate the alternative is challenging. The first imputes whatever changes occur to the program. This is always troublesome, but especially so when earlier situations were unsustainable, as with very large external borrowing. The second assumes that the targets were in some sense optimal and feasible, and that no external events impinged on the country. As such, it provides no way to evaluate the optimality of program design. In practice, all evaluations grapple with these issues. Recent evaluations have been increasingly sophisticated, although no methodology overcomes the problems entirely.

In the 1980s, most comparisons were of groups of countries, contrasting their economic performance in the years prior to Fund or Bank programs with their performance after these programs.[38]

Table 2 reproduces the Bank's findings with respect to the impact and success of its adjustment lending as of 1988. As can be seen, the measured "impact" of external shocks (changes in terms of trade and in world interest rates) was greater in the countries which received SALs, while there was a slightly greater percentage of SAL recipients whose average performance measure improved.[39] It should be noted that most SAL recipients were also under Fund programs, a factor which prevents interpretation of these data as representing the effects of Bank SALs alone.

Perhaps because the Fund's efforts have been concentrated on macroeconomic programs, there have been more efforts to assess their impact than there have for Bank SALs. In 1989, Sebastian Edwards surveyed analyses of the impact of Fund programs.[40] He

[37] Mohsin Khan (1990) reviewed alternative methodologies for all of these approaches, including a comparison-of-simulation (with and without Fund programs) methodology, as well as a comparison of results of earlier studies. See his Table 1, p. 208. One could also contrast countries with programs and those without, but presumably the countries under programs had more unfavorable initial conditions.

[38] The first such attempt was made by Thomas Reichman and Richard Stillson (1978). See also Carlos Diaz-Alejandro (1983) for an analysis of their effectiveness in the Southern Cone countries for about that same time period. Diaz-Alejandro concluded that Fund programs were highly effective in reducing current account imbalances but much less so in terms of achieving other targets.

[39] It is doubtful whether the difference in percentages of improved performance would be statistically significant, but the difference in impact might be.

[40] See Edwards (1989, pp. 27–28) for a list of earlier evaluations, and the review by Khan

TABLE 2
EXTERNAL SHOCKS AND PERFORMANCE

Category	Low-Income AL	Low-Income NAL	Middle-Income AL	Middle-Income NAL	All Countries AL	All Countries NAL
30 AL Country group						
External shocks (as percent of GDP)	4.6	3.8	5.2	1.4	5.0	2.4
Percent of performance measures showing improvement	53	47	55	45	54	56
12 AL-intensive countries						
External shocks (as percent of GDP)	10.3	3.8	7.0	1.4	8.4	2.4
Percentage of performance measures showing improvement	62	38	63	37	63	37

Notes: AL = countries to which the Bank extended Structural Adjustment Loans or Sectoral Adjustment Loans. NAL = countries to which there was no such lending. There were 12 AL countries and 63 NAL countries included in the analysis. External shocks are defined as the terms of trade and interest rate (on external debt) change as a percentage of GDP.

It should be noted that most AL countries (and some NAL countries) also undertook Fund programs.

Performance measures were GDP growth, investment as a percentage of GDP, export growth rate, real exchange rate, current account balance as a percent of GDP, the fiscal balance as a percentage of exports, and the ratio of debt service to exports. These were calculated as the average of the three years before the SAL as compared to the average of the three years after the SAL.

Source: World Bank (1988) p. 4.

summarized the conclusion from these analyses:

> the existing empirical evidence indicates that when compared with the years prior to the program or with a control group, IMF programs have resulted, on average, in: (1) an improvement in the balance-of-payments situation; (2) an improvement in the current-account balance; (3) a slight—although not necessarily significant—reduction in inflation; and (4) a short-run reduction in output growth. (Edwards 1989, p. 32)

He then analyzed the 34 upper-tranche IMF programs that had been undertaken in 1983 in response to the debt crisis, examining both the content of programs and their outcomes. Seventy-six percent of the programs contained provisions for control of current public expenditures; 68 percent stipulated measures to increase revenues; and 79 percent specified changes in aspects of public sector enterprise behavior. Ninety-seven percent of programs contained targets for money and credit aggregates and all contained limits on credit to the government and the public sector. Other measures appearing in programs were exchange rate policy (79 percent called for devaluations), pricing adjustments, debt management (including rescheduling), and trade reform, with 35 percent providing for tariff liberalization and and 41 percent for relaxing exchange controls (Edwards 1989, p. 32).

The before–after comparison in Edwards' set showed some improvement in the current account, but a fairly sharp rise in the rate of inflation and a short-term reduction in the rate of growth of

(1990). More recent analyses include Bird (1995) and Conway (1994). Santaella (1993) and Knight and Santaella (1997) examine some of the determinants of decisions to extend and to accept Fund programs.

output. However, when Edwards calculated the percentage of targets achieved in Fund programs, the results indicated that 30 percent of borrowing countries were in compliance with respect to the fiscal deficit target in 1983, 19 percent in 1984, and 43 percent in 1985. The percentage in compliance with domestic credit targets was about the same, while 72 percent were in compliance with changes in net domestic credit to the government in 1983, and 52 percent in 1984 and 1985 (Edwards 1989, p. 35). Edwards attributed this low compliance rate to the poor incentives confronting heavily-indebted countries, a subject that arises more generally with regard to the Fund's role in crisis management and that is therefore discussed below.

Khan (1990), in addition to providing another survey of earlier work including an excellent discussion of methodological issues, analyzed the impact of Fund programs in 69 countries (259 programs) over the period 1973–88, running a pooled time-series, cross-section test across both Fund-program countries and others. His findings are consistent with Edwards': Fund programs tend to improve the current account and the balance of payments, and reduce the rate of inflation even in the first year (as contrasted with the performance that would otherwise have occurred); however, growth rates are reduced in the short-term. Longer-term results (three years out) showed less negative, and more positive, effects of Fund programs than the short-term results. Khan did note that neither he nor other analysts had been able to take into account the degree of compliance with Fund programs, which continues to be a limitation of all results to date.[41]

[41] A more recent but more descriptive effort is contained in Susan Schadler et al. (1995), focussing on the design of Fund lending programs.

3.3 *Research, Information, and Training*

Both the Bank and the Fund have been widely recognized for their role as information providers, and, to a lesser degree, in intellectual leadership. That role extends all the way from gathering and disseminating primary statistics to research and analysis on a variety of issues.

Turning first to research, the Fund has had an active research role and research output at least since the 1950s. The Mundell-Fleming model, referred to above, was an output of the Fund's research department. So, too, was Sydney Alexander's (1952) absorption approach to the balance of payments.

Under the leadership of Jacques Polak,[42] the monetary approach to the balance of payments, which was later elaborated and extended by Jacob Frenkel and Harry Johnson (1976), among others, was developed. The Fund's Research Department was a leader in raising and analyzing important policy questions, many of which were then addressed by researchers in the fund and in academia. As Polak (1995), who was head of the department from its inception until the 1970s, put it:

> In many places in the world, especially universities and research institutes, the economics of exchange rates are the object of intensive research; and in many other places—governments and central banks, policy councils and newspaper offices—exchange rate policies are matters of active and often heated discussion. But nowhere in the world is the interaction between the scientific and the policy aspects of exchange rates—between 'how do they work?' and 'what should be done about them?'—as close and intense as in the International Monetary Fund . . .[43]

[42] Polak's 1957 article is usually regarded as the precursor of the Mundell-Fleming model and later work on the monetary approach to the balance of payments.

[43] Polak (1995, p. 735). For an assessment of the Fund's contribution to research, see Blejer, Khan, and Masson (1995).

The Fund Research Department has remained active over the years, contributing importantly to analyses of the debt crisis in the 1980s, the properties of alternative exchange rate regimes, the impact of increased capital mobility in the 1990s, and a variety of other topics. In most citation counts, the International Monetary Fund *Staff Papers* fares very well, comprising a significant proportion of citations (for articles, and not data) of international organizations.[44]

The World Bank was much less active in research in the 1950s and 1960s. Its major role in research began with Hollis Chenery, who not only introduced the tradition of seeking empirical regularities across countries, but led in analysis of important issues such as the linkages between growth and income distribution (Hollis Chenery et al. 1974) and other major policy issues of the 1970s. The Bank's Research Department sponsored important work on the use of computable general equilibrium models for developing countries (see Kemal Dervis, Jaime de Melo and Sherman Robinson 1982), on trade policy reform (see Michael Michaely, Demetrius Papageorgiou and Armeane Choksi 1991), and a large number of other issues. The Bank pioneered in putting out its annual *World Development Report,* which annually brings together academic and bank researchers to produce a volume synthesizing knowledge on an important development issue.[45]

To quote Michael Gavin and Dani Rodrik (1995, p. 332):

> A "distinguishing feature of the World Bank [is] its role as a conveyor belt of ideas about development policy to the developing countries. It is difficult to overemphasize the part played by the Bank in this regard. Thanks to its far-flung lending operations, the Bank is the single most important external source of ideas and advice to developing-country policymakers. World Bank research and publications . . . are widely distributed around the world . . ."

In addition to the "pure research" role, however, both the Bank and Fund have contributed to knowledge in important ways. These include the compilation and systematization of basic data, where the Fund's *International Financial Statistics* and the Bank's *World Development Indicators* both provide data used frequently in research.[46] The Bank undertook the Living Standards Measurement Study, which has been a valuable source for research on household-level questions pertaining to demography, education, labor market participation, and income distribution. (See Margaret Grosh and Paul Glewwe 1989). The Bank is also the agency which collects debt data and publishes them annually in its *Debt Tables.*[47]

It is difficult to evaluate the importance of collection and presentation of cross-country statistics. To obtain a rough quantitative indicator, "counts" were taken for selected years as to the number of articles in specified economics journals that used World Bank or IMF data or analyses as an input for

[44] See Blejer et al. (1995). In Evren Ergin's count undertaken for this article, the *Staff Papers* did very well, accounting for a significant proportion of citations to articles and books published under IFI auspices.

[45] In contrast to the Fund, the Bank did not publish any journals on development economics until the mid-1980s, when the *World Bank Research Observer* and the *World Bank Economic Review* appeared.

[46] The Bank was one of the organizations providing funding for the studies leading up to the Summers-Heston data set, which has been extensively used in cross-country growth regressions.

[47] As an institution owned by member governments, neither IFI can undertake primary data collection without a mandate. Even then, the institutions must take care to present data in ways that are acceptable to member governments. The Bank's debt data are the only primary statistics collected by either IFI.

TABLE 3
REFERENCES TO IFIs IN ARTICLES IN GENERAL JOURNALS
(NUMBER OF ARTICLES)

	1950	1960	1970	1980	1990	1994
International	18	16	36	34	30	24
Empirical	6	7	21	17	13	16
Use data	1	1	4	8	3	3
Reference	1	0	3	8	7	9
Analytical	12	9	15	17	17	8
Reference	1	3	1	1	2	1
Other	65	62	99	116	130	125

Source: *American Economic Review, Economic Journal* and *Journal of Political Economy* article counts; international subjects were determined by JEL classifications.
Note: "Use Data" and "reference" refer to citations to IFI sources and publications. For example, of the 21 articles with an empirical focus on international issues in 1970, four used data with sources given as one of the IFIs, while three referenced other publications of one of the IFIs.

TABLE 4
USE OF IFI DATA AND PUBLICATIONS IN INTERNATIONAL JOURNALS 1980 TO 1994

	1980	1990	1994
International	77	93	75
Empirical	38	49	40
Data	13	23	18
Reference	15	36	21
Analytical	39	44	35
Reference	6	11	10
Other	24	17	25
Empirical	19	14	22
Data	0	0	4
Reference	1	4	9
Analytical	5	3	3
Reference	1	1	1

Source: Article count in *Economic Development and Cultural Change, Journal of Development Economics,* and *Journal of International Economics.*
Note: See Note, Table 3.

research. Tables 3 and 4 provide the results. Table 3 gives the total number of articles, the number of articles that could be counted as "international", and the number that used Bank, Fund, or GATT sources, in every tenth year starting in 1950, through 1990, and for 1994 for "general journals," that is, the *American Economic Review,* the *Economic Journal,* and the *Journal of Political Economy.* Table 3 gives the counts for *Economic Development and Cultural Change,* the *Journal of International Economics* and the *Journal of Development Economics.*

As can be seen, even in the general journals, the number of international articles accounted for about a fifth of all articles in general journals until 1980. Thereafter, the fraction fell somewhat, perhaps because more appeared in the specialized journals (see Table 4). The amount of empirical work increased significantly, with about half of those in general journals relying on data from, or referencing, IFI-published material. For the specialized journals, reliance on IFI material was even greater, with more than half of the empirical articles based at least in part on IFI sources, and even the analytical articles contained IFI references about a third of the time.

Whether the greater availability of data permitted more research on international economics, or whether the subject matter was simply becoming more important, is an open question. Nonetheless, there can be little question that Bank and Fund-provided data and publications are significant sources for academic authors of journal articles.

It might be argued that if the IMF, World Bank, and GATT/WTO had not provided data, another—perhaps private—agency would have done so.[48] However, the fact that the World Bank and the IMF are undertaking other activities probably provides them with an edge in obtaining data from member governments. It is at least as likely that, in the absence of the other relationships between the multilateral institutions and individual governments, the data would be forthcoming later, in less reliable form, and be less accessible for researchers and other users.[49]

There are three aspects of "training" under Bank and Fund auspices, all of which are arguably under-appreciated. First, many people spend several years employed at one of the institutions, learning about economic structures, responses, and policies in a comparative context. On return to their countries, they are often linchpins of the economic policy teams (and occasionally even top politicians).[50] Second, both the Bank and the Fund provide training, through their institutes and through programs designed to support civil servants in member countries. Third, the Bank has financed thousands of students from developing countries as they pursued their studies abroad.

Harberger (1984, p. 11) has analyzed the "tutelage" function, as he calls it, the best:

> I hold . . . the profound conviction that the World Bank and . . . the International Monetary Fund have performed extremely important tutelage functions in ways that many people do not realize. I am . . . referring to the upgrading of member country personnel through a) the apprenticeships that many of them serve as staff members of the Bank and Fund, b) the direct lessons, learned by government personnel in member countries through dealing with missions from the two sister institutions, and c) the similar but rather more specific lessons that member country cadres have learned by going through the Bank's process of project evaluation at the various stages of a project's development. Each of the above entails a special kind of on the job training' that the Bank (and for the first two, the Fund) are in my view uniquely qualified to impart.[51]

There are also more formal training activities. Both the Bank and the Fund have institutes that sponsor courses for mid-level officials in project evaluation, monetary economics, maintenance of debt statistics, and a variety of other governmental functions. Harberger (1984, p. 14) rates their contribution as being very high. He recommended that the Bank "should place first priority on its tutelage role," including both the EDI (Economic Development Institute)

[48] In the wake of the 1982 debt crisis, some of the large international banks believed that better statistics would be valuable. The Institute of International Finance was established, funded by private commercial banks. It is significant that the Institute, while obviously playing a valuable role, is not a widely cited source of statistics or analyses.

[49] It may be significant that one of the most frequently voiced demands placed to the International Monetary Fund after the Mexican devaluation crisis of December 1994, and again after the Asian crisis in the summer of 1997, was that the Fund should see to the collection and dissemination of more timely data from individual members.

[50] John Williamson (1994a), in his 50th anniversary evaluation of the IFIs, indicated that "A period of service in one of those organizations provides the best training for economic policy-makers available in the world today. . ."

[51] In the late 1970s and early 1980s, the Bank sponsored training for civil servants in developing countries to enable the provision of more accurate and more timely data on debt. Those who completed the debtor-reporting training were typically promoted to other jobs, presumably deemed more important by host countries, within a matter of months after returning to their countries. Whether this attests to the quality of Bank training or of the people selected for it is not clear.

programs and the linkages with country lending programs.

3.4 *Policy Advice*

Both the Bank and the Fund are concerned with the economic policies pursued by individual developing countries. Experience has taught that the real returns on any investment in a country are in significant part a function of the overall macroeconomic framework within which investment takes place. Hence, the World Bank focuses, or at least should focus, on policy issues even when undertaking project lending.[52] And, since economic policies strongly affect growth prospects, the World Bank's Structural Adjustment Lending supported changes in economic policy. Many of the same issues are, of course, also central to the Fund's lending programs.[53]

Many of the policy changes supported by the Bank and the Fund (in, for example, exchange rates, sizes of fiscal deficits, trade liberalization, agricultural and energy price reforms, privatization, and tax reform) are ones that would be endorsed in broad outline, if not in details, by almost all economists. Criticisms of these policies normally center on whether policy changes have gone far enough to be effective or whether they have been so abrupt (or otherwise poorly designed) so that there have been wrenching impacts on the poor (see discussion of criticisms below).

Gavin and Rodrik (1995) believe that policy advice has actually been the central activity of the IFIs. Although their focus was exclusively on the Bank, their analysis could apply equally to the Fund.

> It is more plausible to locate the Bank's comparative advantage in assisting development in the presence of weaknesses and distortions in member countries' domestic political processes than in overcoming the international capital-market imperfections that so concerned its founders. The Bank's role as policy adviser and institution-builder has been the key to its impact on economic development. (Gavin and Rodrik 1995, p. 331)

Estimating the impact of the policy advice is difficult. (See Krueger, Vernon Ruttan and Constantine Michalopoulos 1989, ch. 6). First of all, there are always various groups within governments, some of which oppose and some of which support change. Bank staff and the possibility of resources can strengthen the supporters of reform and weaken the resistance of some opponents. Judging whether policy reform was pushed "hard enough" is problematic. Second, it is not always clear when, and to what extent, policy advice has been accepted. Bank staff may for years advocate reforms before change can occur, but at least in some instances it is demonstrable that earlier discussions influenced policy makers at key points. Third, some governments want to claim credit for policy reform under all circumstances, while others want to blame the entire set of policies on foreign devils. Given diplomatic constraints on the behavior of participants, the true negotiating positions are often not known.

3.5 *Are There Economies of Scope Across Lending, Policy Advice, and Research and Training?*

A strong case can be made that the functions of lending, policy advice, training, research, and provision of

[52] There is little point in lending to support increases in agricultural productivity through research and extension activities, for example, if producer prices for agricultural commodities are significantly depressed through domestic policies or the exchange rate.

[53] For analyses of a variety of Fund policies, see the essays in Williamson (1984). For a review of Fund conditionality, and a listing of all Fund programs, see Guitian (1995).

information of both the Bank and the Fund are mutually complementary and that the spillovers from each of these functions to the others are large. Polak's comments on Fund research, quoted above, indicate his belief in the importance of the stimulus to research coming from close-hand awareness of the policy issues. Likewise, decision-makers in national governments may be more willing to provide reliable data and to listen to policy advice when there are possibilities of receiving loans. Further, the contact that Bank and Fund staff have with conditions prevailing in individual countries may give them an edge in analyzing countries' individual situations.

It could also be argued, of course, that the costs of learning a sufficient amount about economic policies in a country are sufficiently high that it does not make sense for many individual industrialized countries each to invest in that effort, and that a pooling of the costs is economic.[54] This was, to a considerable extent, the rationale behind the Task Force on International Development Report (1970) which shifted U. S. foreign aid efforts more toward the World Bank and the IMF and removed much of the capacity for macroeconomic policy evaluation from the Agency for International Development. However, that was at a time when private capital flows were a tiny fraction of their levels today.

It can, however, be asked whether, in order to carry out the policy advice and knowledge provision functions, the Bank and Fund lending functions are essential. Rodrik (1995) has provided the most thoughtful answer.[55]

> In practice close monitoring of a government's policies is almost always undertaken in the context of a lending program, even when the government has access to private flows and no demonstrable need to borrow from multilateral sources. The World Bank or IMF seal of approval takes the form of a loan, not a pronouncement. There are two possible explanations for this linkage. First, governments may be less willing to open up their books to outsiders if doing so does not lead directly to financial flows. Although this explanation carries weight in some instances, it is not a strong argument for linking monitoring with lending . . .
>
> The second argument is more credible. In the absence of direct lending by multilateral agencies, there is very little to ensure that these agencies will exercise their informational function as competently as possible. If their own money is not at stake, they may be more easily influenced by political demands . . . in their certification of credit worthiness. (Rodrik 1995, p. 174)[56]

3.6 *Criticisms of the Bank and Fund*

It is difficult to think of an activity of either IFI that has not been subject to criticism (either for undertaking it or failing to) from both sides. The IFIs are perhaps bound to be criticized regardless of what they do, and many of the criticisms are in any event of a type that, if consensus as to desirable policies were reached, correction could be relatively easily undertaken. In that sense, many are second-order in terms of considering the future activities of the IFIs.

It is worthwhile nonetheless to

[54] It has been argued that Bank and Fund's policy advice prevents receipt of conflicting advice from different donors. The Bank and Fund have organized "consortia" of countries financing particular policy reform packages and have, thus, played the role of coordinator on many occasions. However, there are also reports of receipt of conflicting advice from different agencies. There are also legitimate concerns about any establishment of a "monopoly" of advice, especially when the determination as to relative quantities and importance has a sizeable judgmental element. As will be discussed below, there have even been times when Bank and Fund advice have conflicted.

[55] See also Kathryn Domingues (1993) for an analysis of the monitoring role for the Fund.

[56] Rodrik does note that the IFIs' refusal to subordinate their claims to those of the private sector to some extent undermines this argument.

provide an overview of some of the criticisms and concerns. Fortunately, an excellent survey in the *Economist* did just that several years ago. Here, that itemization of charges is first presented. Thereafter, a few of the criticisms, which are crucial for evaluating the future role of the IFIs, are considered.

Clive Crook (1991, p. 6) provided a succinct account of the various criticisms leveled against the institutions:

> Critics say that the Bank and the Fund:
>
> - apply identical remedies, irrespective of a country's circumstances;
> - support programs that do not work;
> - are anti-growth;
> - harm the poor;
> - impose austerity on member countries;
> - bail out the commercial banks;
> - have a market-oriented, free-enterprise philosophy which they apply in a doctrinaire way;
> - ignore the views of governments of developing countries;
> - have no influence over the governments of rich countries;
> - collude in dealing with developing countries.
>
> This list, though long, is far from complete. Both institutions have also been accused, from the left, of keeping wicked right-wing regimes in power. Many more complaints, from both left and right, are aimed specifically at the Bank. Conservationists say its investment programs have damaged the environment. American conservatives bemoan its policy of lending mainly to governments (either directly, or by insisting on a government guarantee).

Many of the complaints listed by Crook pertain to activities in the past, and need not be of concern here, where focus is on the future role of the IFIs. There are, however, several criticisms which are deserving of attention.[57] These include: 1) the question as to whether the failure of some developing countries to achieve satisfactory growth indicates that Bank and Fund programs were ineffective; 2) the linkages between IFI lending and the role of governments in developing countries; 3) the connection between the "hardness" of IFI programs and the impact on the poor; and 4) criticisms of the bureaucracies of the two institutions, and especially the Bank. Issues of "bank-bailout" are deferred to analysis of crisis management in the next section.

Turning first to the failure of some developing countries to achieve growth,[58] Doug Bandow and Ian Vasquez (1994) have been among the prominent critics:[59] "Multilateral lending institutions—the International Monetary Fund, World Bank, and regional development banks—have flooded the Third World with hundreds of billions of dollars in aid. Since the early 1950s, the World Bank alone has lent developing countries nearly $300 billion . . . Yet after providing advice,

[57] Some "complaints" are difficult to interpret. Consider the criticism that country programs are "identical." If the Fund or Bank had entirely different programs for each country in which they are active, that surely would be grounds for criticism. And it is obvious that the programs are not literally identical. Key policy variables (e.g., exchange rate, nominal interest rate, fiscal deficit, etc. in Fund programs) are touched in most (but certainly not according to a formula that anyone can readily replicate) programs, but that is not surprising given that the foreign exchange difficulties that normally prod a government into approaching the Fund are interrelated with key macroeconomic variables.

[58] Focus here is on the argument as concerns IBRD and IMF activities. The allegations regarding IDA are normally that they do the same "wrong" things as the IBRD. Critics of lending under IDA normally consider it self-evident that structural adjustment lending and infrastructure support "do not help the poor." Since it requires very little economic theory to understand that the general equilibrium effects of infrastructure and other investments, as well as more rapid economic growth in general, may help the poor more than "direct" assistance (whatever that is defined to be), I do not consider the argument here. For a representative sample of the critique of IDA, see Lori Udall (1994).

[59] But see also James Bovard (1994).

loans, and grants to the governments of the world's poorest countries for four decades, the multilaterals can point to few, if any, cases in which their efforts have led to improved living standards and sustained economic prosperity."[60]

There is no question that living standards have risen in most developing countries.[61] The key issue is whether Bank and Fund lending were supportive of growth, and a careful analysis of that question has not been undertaken, in part because of its difficulty.

To analyze what the Bank and Fund have contributed requires recognition of several facts. First, one can contrast the growth rates of developing countries (total or per capita) in the postwar period with that of earlier times. On that criterion, growth has clearly accelerated.[62] Second, one can contrast growth rates (or other indicators of success) of developing countries with postwar forecasts; again, one finds that growth exceeded the forecast rate.[63] These arguments, of course, do not prove the growth might not have been faster without Bank and Fund support, but they do suggest that growth was reasonably satisfactory and that the international institutional environment cannot have been greatly harmful to growth.[64]

One can also turn the question around, and ask how much difference the IFIs might reasonably have been expected to make. A plausible upper bound on that difference can be estimated by noting that there is no country outside Subsaharan Africa where the total capital inflow has amounted to more than 2 percent of GDP annually, and in most it has been significantly smaller. If one estimates that the net real rate of return (i.e., net of whatever loan repayments or dividend repatriation

[60] The authors cite the World Bank's 1992 *Annual Report* as the source of their $300 billion estimate. I am unable to verify that number. It is hard to think of a test to determine whether there has been "sustained economic prosperity." But certainly, life expectancies have increased dramatically in most developing countries, as have standards of nutrition and literacy. And, in almost all developing countries (the exceptions being heavily concentrated in Sub-Saharan Africa), living standards are arguably well above the level of the 1940s and 1950s. One wonders how Bandow and Vasquez would classify the East Asian and Southeast Asian economic performances, where living standards have risen rapidly and where the IFIs were a source of finance.

[61] Even for Sub-Saharan Africa, which has had the greatest economic difficulties, there is considerable evidence of improvements in life expectancies and access to education and health care. The World Bank estimates that per capita income in constant prices for all low-income countries rose at an average annual rate of 2.7 per cent per annum from 1965–83, and fell at an average annual rate of .7 percent from the early 1980s to 1995. (World Bank 1985, p. 174, and 1996). Sub-Saharan Africa is estimated to have experienced declining per capita income at an average annual rate of less than 1 percent, with population growth in excess of 3 percent in many countries. Even if the figures are a reliable indication of per capita consumption, one would have to analyze the welfare implications of larger family size (resulting from reduced infant mortality) before concluding that there had been no benefits. That economic growth would have delivered more rapid increases in living standards under altered economic policies is, however, undeniable.

[62] For example, India is regarded as one of the laggards in raising per capita income in the period prior to 1990. Yet estimates are that real per capita income grew at about 1.8 percent annually starting in the 1950s, contrasted with a rate of about 0.5 percent a year in the preceding half century (or longer). To be sure, more rapid growth of developing countries might be attributable to other changes. For example, the entire international economy grew more rapidly in the postwar years, and the more rapid growth of developing countries might well be the result of that.

[63] See David Morawetz (1977) for an evaluation during the World Bank's first quarter century.

[64] Bandow (1994, p. 35) provides an appendix in which he lists countries by the length of time they used Fund credit, arguing that repeated use is per se evidence of failure. In his list of countries using Fund credit for 30 years or more are Chile, Egypt, India, Sudan, Turkey, and Yugoslavia. Of those countries, all but Sudan and Yugoslavia have significant improvements in living standards, if less than might have been attainable under other policies. Most observers would classify Chile as a success story.

occurred) to that capital inflow was 10 percent—surely a high number—[65] then the total capital inflow could have resulted in a higher rate of economic growth (both total and per capita) of no more than 0.2 percent per annum.

While two-tenths of a percent per year is significant in the context of poverty, given the imprecision with which weights can be assigned to factors contributing to growth, it is difficult to understand how the IFIs, or capital inflows in general, might have been expected to result in a quantum leap in economic performance. To the extent that their contribution was any greater than this two-tenths of a percentage point, it surely resulted from the fruits of policy advice, technical assistance, training and the more rapid spread of knowledge, and other informational services provided by the IFIs. Expecting more of the IFIs would therefore imply a very high product of the research-information-policy-advice functions.

Even if one concludes that project lending, and some program lending, to countries such as South Korea, Chile and Thailand may have played a positive role in their success, one can ask whether lending to some of the less rapidly growing developing countries may have been unwarranted.

Here, the case that Bank lending, and even some Fund programs, may have been too "soft" is stronger. For example, until the late 1970s, Bank support (and that of many bilateral aid agencies) of Tanzania was enthusiastic.[66] In hindsight (and even in the eyes of many economists at the time), Tanzania's economic policies did not augur well for prospects of successful development. There was also Bank lending in support of such activities as steel mills, fertilizer projects, pulp and paper plants and tourism in the public sector which was, judged by present-day standards, clearly ill-advised. But as development lessons have been learned, Bank policies with regard to lending have altered, and in that sense the criticism, while certainly having merit with regard to past behavior, is not necessarily germane to consideration of future activities. Indeed, it should be noted that it was the Bank's own report on Sub-Saharan Africa in 1982 that first called many of these economic policies into question (World Bank 1981).

The sophisticated criticism of the IFIs focuses on their role in strengthening governments (since their lending is to governments) more generally. It is argued either that lending to governments per se strengthens them and is undesirable or that the availability of IFI support has permitted governments to pursue inappropriate policies longer (or in more extreme fashion) than they otherwise would have.[67]

[65] But see Harberger (1972 p. 355). Harberger used 10 percent as the return in his classic paper, and was the first to point out that capital flows from official lending and aid could not have been expected to have had a large macroeconomic impact on growth rates.

[66] The same sorts of statements could be made about support to Ghana, Sudan, and a number of other countries where economic policies were disastrous for resource allocation and growth. Even in these cases, however, questions remain as to whether support for such activities as increasing the percentage in primary schools, health clinics, and agricultural research and extension may not have a high real rate of return.

[67] This is an argument that is often used to advocate more lending by the IFC and less by the IBRD. A legitimate case can be made for some of this shift (see Ryrie 1995), although there are two major qualifications. A first is that the IFC is directed to lend only when the private sector in the country will not finance the venture. The second is that private sectors can perform only when government is also assuring that infrastructure is in place. This latter is clearly a legitimate role of government; efforts of the IBRD to lend to improve roads, ports, agricultural research and extension, and other activities of that nature can be complementary to private development.

A first consideration is that not all strengthening of governments is bad. Government sufficiently strong to provide a secure set of property rights and a rule of law governing contracts is recognized to be a sine qua non for satisfactory economic growth. It is not necessarily true that all lending to governments increases undesirable controls over the private sector or usurps private sector activity. Financial sector liberalization can remove credit rationing and thus prevent government direction of credit; trade liberalization, and especially the removal of import licensing, can greatly reduce bureaucratic power; and support for policies freeing agricultural prices or removing state marketing board monopolies over inputs or outputs can greatly reduce government controls on agriculture, to mention just a few examples of lending to governments in support of activities that reduce the control of the public sector over private sector activities.

There are, no doubt, still Bank and Fund programs that tend to strengthen governments in unwarranted ways. Nonetheless, many Bank and Fund programs have been associated with liberalizations of the type described above. Others have led to pricing services of public infrastructure, such as water and power, at prices more closely reflecting opportunity cost.

In recent years, some critics of the IMF have even gone to the opposite extreme, arguing that the IFIs should have done more, especially in the context of economies in transition, to develop an appropriate framework of property rights in support of markets.[68] It seems clear that, in considering the future of the two institutions, their activities need to be geared to strengthening the private sector and the appropriate role of government in relation to it. That IFI activities must necessarily strengthen the undesirable activities of government, however, is certainly not the case.

This immediately leads to consideration of the third question, whether Bank and Fund programs may not have imposed undue hardship on the poor. In contrast to those who believe that programs were too "soft," this criticism originates from those who believe that the focus of the IFIs on growth has neglected the poor.

For economists, the difficulties with the argument are well known and require only brief repetition here. When countries' policy reform programs are criticized, an important issue concerns the counterfactual: had the downhill slide continued in Ghana, for example, it seems unarguable that the poor would have been worse off still. Indeed, over the longer run, the poor have experienced more rapid increases in living standards in countries achieving higher overall rates of economic growth, so that a focus on growth over the longer term is an essential component of an anti-poverty strategy. Moreover, those most adversely affected by reforms are often the highly protected groups (employees in parastatal enterprises, union members, etc.) who are in fact among the privileged.

That said, however, in response to this criticism, the IFIs (and many other institutions including regional banks and national governments) have attempted to find ways of "targeting" assistance to those poor most adversely affected by policy reform programs. In so doing, the costs of these transfers have been significantly reduced, while a significantly higher fraction of the benefits have been received by the target groups.

A final frequently-voiced criticism

[68] See, for example, Allen Meltzer (1998).

that deserves attention is aimed at the staff of the IFIs. On one hand, there have been criticisms of the compensation packages of the staffs,[69] but that could, if valid, be relatively easily corrected. On the other hand, there are criticisms of the functioning of one or both of the bureaucracies. Roland Vaubel (1994, 1996) argues that the Fund (and Bank) engage in bureaucratic maximization, and that much of its lending is to further bureaucrats' objectives, rather than to assist developing countries. Bruno Frei (1997) recently provided a valuable survey of the public choice perspective on international organizations, and considered ways in which incentives within the bureaucracies may be aligned more closely with the desired objectives.[70]

Research along these lines, however, is, as Frei notes, in its early stages. Meanwhile, many of the criticisms are especially aimed at the behavior of the World Bank. Virtually every new president of the World Bank has undertaken a reorganization, partly in response to these criticisms. For example, when James Wolfensohn became president of the Bank, he promised to "break the armlock of bureaucracy on the institution," and to create a "results-oriented culture" (see Michael Prowse 1996).

Quite apart from questions surrounding the Bank's future role, many critics have suggested that the Bank's bureaucracy and organization are so unwieldy that effective implementation of an agreed-upon mission would be challenging, as indicated in the Crook quote cited above. To a degree, the argument can be turned around: the Bank has undertaken so many functions in addition to its initial development mandate that the organization has been affected. At any event, unless there is a consensus as to the Bank's mission, questions of its organization do not seriously arise. I turn, therefore, to questions as to the Bank's and the Fund's future roles and proposals for change.

4. *Future Roles of the Bank and Fund*

The IFIs were established with a fairly clear idea as to what their role was to be and why. The world—or at least economists' understanding of it—has obviously changed, and neither the "missing market" rationale for official capital flows from the World Bank nor the rationale for the Fund as a guardian of the system of "fixed, but adjustable" exchange rates is sustainable any longer.[71]

Natural questions that arise pertain to the role the IFIs' current activities

[69] Setting compensation at international institutions is inherently difficult. There are two principles that are generally accepted. The first is that people doing equal work should receive equal compensation. The second is that the IFIs should have an international staff. From these, it follows immediately that compensation should be set at around the levels of compensation in the most affluent member countries (or nationals of those countries will be underrepresented among the staff).

[70] One of Frei's arguments is that when bureaucracies are aware that they have competition, their performance is improved. This would suggest that having the IFIs, as well as regional banks and other agencies, supporting developing countries may be desirable despite apparent "duplication," and is relevant when proposals to "merge" the Bank and Fund are considered. Frei also points out that aligning voting power with financial contributions renders an international organization more likely to be fiscally constrained (as perhaps evidenced by the differences between the UN where a one-vote, one-country rule prevails and the IFIs where voting is weighted).

[71] It can, of course, be argued that private capital flows to developing countries are on terms that are too short, or are not available in a timely fashion, or that there are other market failures. Many observers are highly skeptical of the "rationality" of short-term capital flows and swings in capital flows to developing countries. In the case of Fund operations, it has also been argued that private surveillance of countries' policies is often too late for least-cost corrective action. See Michael Mussa et al (1994).

play in the world economy and whether changes in their activities might improve world welfare. Ideally, answers to those questions would require an agreed-upon analytical framework with regard both to the public goods that might be provided in the international economy and to the appropriate set of international organizations. Neither of those frameworks is at present adequately developed to provide a basis for analysis of the future role of the institutions. Nonetheless, it is worthwhile to consider briefly what such rationales might be.

4.1 *How Does One Analyze the Role of International Organizations?*

An obvious point of departure for analysis of international institutions is the absence of a world government and the proposition that there may be global public goods or externalities across national boundaries.[72] From that starting point, there could be three—not necessarily mutually exclusive—ways to proceed. One would be to examine the incentives for, and potential gains from, cooperation, and the possibility for framing rules or institutions that can permit attainment of an outcome Pareto superior to an international regime of laissez-faire. A second way would be to inquire as to the sorts of international public goods and/or externalities that may be associated with international transactions, and then to analyze alternative mechanisms for supplying them in appropriate amounts. A third approach is more positive in nature, using public choice theory to analyze international institutions, seeking to understand their rationale and the ways in which they evolve.

None of these approaches has been developed significantly. Frei's (1997) survey of the public choice literature on international organizations has already been noted. Efforts to examine the provision of public goods by international organizations and of the potential gains from coordination have been made primarily in the context of international money and the IMF. But these have bogged down for two reasons. First, the G-7 (or an even smaller group of ministers) are the group that in fact orchestrates whatever coordination is achieved, and the Bank for International Settlements has assumed a coordination role for central banks. It is therefore academic to discuss a major role for the Fund. Second, there is not even agreement as to whether there are potential gains from coordination.[73] Feldstein (1988) has been prominent in pointing to potential dangers of macroeconomic policy coordination.[74]

A second sort of public good may be rising standards of living in poor countries. But, beyond assertions that poverty reduction is a "public good" and can thus best be achieved through international cooperation, little use has been made of the public good approach to evaluating the role of the Bank as a development institution.

Even if such a framework were

[72] See Charles Kindleberger's (1986) Presidential address on the subject. Kindleberger identified the international public goods most interesting to him as "trading systems, international money, capital flows, consistent macroeconomic policies in periods of tranquility, and a source of crisis management when needed. By the last I mean the maintenance of open markets in a glut and a source of supplies in acute shortage, plus a lender of last resort in acute financial crisis . . . " (p. 8).

[73] There is also an issue of coordination, or overlap, between the IFIs and the WTO. In the parlance of the international community, the achieving of "coherence" between trade, exchange rate, monetary, and other policies is a major concern.

[74] In the early postwar years, the experience of the 1930s led many to believe that macroeconomic coordination was virtually the bedrock which any well-functioning international economic system would require.

available, it would first need to be applied to international organizations generally. The IFIs are only two of a large num ber of international organizations. Frei (1997, p. 106) reports that "there exist at least 350 intergovernmental international organizations with far more than 100,000 employees." He further notes that growth in their numbers has taken place primarily since 1939; moreover, the individual organizations have grown very rapidly.

Even if attention is confined to sizeable international organizations dealing in international monetary and development issues, there are regional development banks, the Bank for International Settlements, UNCTAD, the OECD (with its Development Assistance Committee and recent efforts to develop a multilateral investment code) and the World Trade Organization, not to mention the G-7.[75]

How functions should be assigned across these organizations is a question far beyond the scope of this paper, but in any overall theory of organizational design, it would surely come prior to focussing on assignments of particular functions to the IFIs. In addition to those dealing with monetary issues, regional development banks, the World Bank, UNDP and UNCTAD all are concerned with development issues.[76] Issues of optimal global institutional design, however, have received little attention. They are therefore ignored in what follows.

[75] Some "competition" across international organizations may be efficient, as pointed out by Frei (1997), both to keep them responsive to members and because the failure of any one organization to meet the needs of the international economy will likely be met by another one anxious to expand its mandate.

[76] The question has practical relevance at present, as the World Trade Organization was charged, in its ministerial meeting in Singapore, with seeking ways to provide "coherence" in the activities of the IMF, the World Bank, and the WTO.

For present purposes, I address the question of the IFIs' future roles in light of current policy discussions. That is, given the current set of other international organizations and of arrangements between governments, what is a desirable role for the IFIs?

In the case of the World Bank, there are three alternatives: 1) continue to be a development institution, focussing only on those countries that are truly poor and gradually phasing out activities in the middle-income countries; 2) continue to operate in all client countries, focussing on the "soft issues" of development such as women's rights, preservation of the environment, labor standards, and encouragement of nongovernmental organizations (NGOs); or 3) to close down.

For the Fund, there are few proposals to extend its activities to arenas significantly different than those in which it now operates. Instead, concerns are expressed as to how, in a world of high private capital mobility, the Fund can continue its historic role with individual developing countries when they confront balance of payments difficulties or crises, without at the same time providing assurance to potential lenders that they will be "bailed out" and can therefore lend safely without adequate regard to country risk.

Comparative Advantage of Bank and Fund. Since both the Bank and the Fund deal with various aspects of economic development, a first question is their comparative advantage in this endeavor, as contrasted with bilateral aid programs or private capital markets. Gavin and Rodrik (1995, p. 330) have provided one partial answer:

> The Bank is not generally considered the "property" of any country or group of countries. The Bank's policies often attract enormous hostility from both governmental and nongovernmental observers but because of its

> international character the hostility generated by unpopular advice and conditionality is almost certainly less, and its ability to withstand political pressures substantially greater, than could be true of any national development agency.

In part, private agents do perform some of same functions as the IFIs. However, private creditors are often unwilling to extend credit unless the Bank and Fund have first signaled their acceptance of economic policies. Rodrik (1995, p. 179) cites an instance in Peru where private lenders attempted to take on monitoring functions, only to abandon them within a short period of time. In Mexico in 1985, private lenders were unwilling to roll over loans unless the IMF certified that Mexico's policies were adequate to warrant a Fund program, even though Mexico did not seek an actual Fund program at that time.

Moreover, the Bank and Fund operate—in different ways—in countries where private capital markets are not functioning well. In the case of the Bank, IDA credits and Bank loans constitute a very large fraction of the capital available to Subsaharan African, and a number of other low-income countries.[77]

4.2 *The Future Role of the Bank*

Over the first half century of its existence, the Bank established itself as the premier development institution. For developing countries without access to private capital markets,[78] it was virtually the only source of long-term external capital apart from bilateral aid and direct foreign investment in selected, usually minerals, activities. And, as seen, Bank technical assistance in project design and implementation was an important by-product, or component, of project lending.

For many of the more rapidly-growing developing countries, local capabilities for formulating and implementing projects are now well developed and, in addition, as seen in Table 1, there is ample long-term private capital available to support economically viable projects.[79] Moreover, given the political constraints on the Bank's relations with its member countries, it is likely that the discipline of private capital markets will be at least as great as that that can be imposed by the World Bank.

Hence, in terms of its traditional role of project lending, if a case can be made for continued Bank involvement, it is for some low-income countries, especially in Subsaharan Africa and South Central Asia.[80] Even then, there are issues as to when project lending can be productive in the context of an inappropriate overall set of economic policies, institutions and incentives.

These considerations would suggest a phase-out of new lending in most circumstances for middle-income countries. There might be two exceptions: first, in some middle-income countries

[77] While the lack of creditworthiness of many of those countries is certainly the result of their own economic policies, private capital is generally not forthcoming until a policy reform program has been yielding results for several years.

[78] It was at least as arguable that private capital markets were not functioning well as it was that poor countries were not creditworthy in the 1950s and 1960s. As such, the initial rationale for Bank support of developing countries—that there were reasonably high rates of return and that private markets would not generate capital flows to take advantage of them—was clear. As such, the desirability of development assistance was almost universally accepted, and the arguments for provision of this assistance through a multilateral institution ran along the lines sketched by Gavin and Rodrik and quoted above.

[79] It is sometimes objected that private flows are volatile, and that one reason for the World Bank's presence is that official lending can accelerate should private capital flows drop sharply. This was certainly the case in 1981–83.

[80] See Krueger (1986) for an elaboration of the argument.

where the present set of economic policies is appalling, the availability of World Bank lending (and IMF programs) could enable more rapid adoption of economic policy reforms were a reform-minded government to come to power;[81] second, there can be times (perhaps including the Asian crisis) when experience of World Bank staff can be valuable in supporting policy reform in a particular sector or sectors such as banking.

Should the Bank refocus on development, with emphasis on the poorest countries, there would be three subsidiary questions: 1) the domain of countries within which Bank lending is still desirable; 2) the type of lending and extension of IDA credit that is desirable; and 3) whether the Bank as an organization is capable of adapting to a role that would make sense over the next several decades.

Turning to the first issue, most Latin American and Southeast and East Asian countries now have such adequate corps of experienced personnel and sufficient access to private capital markets that it makes little sense for the Bank to be undertaking ordinary project lending in these countries. However, the newly independent countries of Central Asia as well as most African countries can benefit considerably from the Bank's continued role as a project lender. The same is probably true of other very poor countries, such as Haiti, Nepal, and perhaps some other South Asian countries.

Even if policies in those countries were conducive to economic efficiency and growth, the absence of basic infrastructure (and often the absence of experienced people in the relevant parts of government) would constitute major obstacles to rapid growth. Since most of these countries are not currently creditworthy, and since the Bank's record as a project lending institution is good, it would seem natural to focus on these countries.

But there are questions as to the types of lending that should be undertaken. This question must be considered in two circumstances: when the overall policies of the country are deemed unsuitable for sustained growth; and, alternatively, when poor countries are embarked upon, or have undertaken, serious policy reform programs.

Many of the very poor countries, plus some middle-income countries, are greatly in need of major overhauls in their economic policies. Until such an overhaul is underway, evidence strongly suggests that Bank lending should be confined to basic infrastructure (including education, health, development of agricultural research and extension capabilities, and so on) which can simultaneously improve peoples' earnings streams even under poor policy and provide an improved resource base, available when policy reforms do come.

In the second case, the range of Bank support could be larger. Infrastructure projects outside the circumscribed domain described above could be supported until it became evident that the countries were sufficiently creditworthy to attract long-term private capital. Perhaps more significantly, the activities of the IFC could assume larger proportions in low-income countries once policies were deemed appropriate.

When governments of low or middle-income countries do attempt serious policy reform, a strong case for Structural

[81] Since serious economic policy reform inevitably must challenge some vested interests, financial support enabling a more rapid transition to the new policies and greater expenditures to ease the difficulties of adversely affected groups than would otherwise be feasible can reduce political opposition significantly. See Robert Bates and Krueger (1993, ch. 10) for a discussion.

Adjustment Lending can be made. Here, the Bank might support not only low income countries, but also middle-income countries where there are major inefficiencies arising from existing policies.

For the Bank to play this role, it would need to differentiate carefully between countries where reforms are serious and stand a reasonable prospect of success and those in which window dressing is used as a means of seeking additional funding.[82]

The Bank's project and policy role in the poor countries (financed in part by further IDA replenishments) would entail a continuation of its comparative perspective and research functions (including especially its *World Development Report*), which have been highly useful in bringing current insights in development to policy makers in countries where otherwise it would be difficult to stay abreast of developments and comparative experience.

Thus, the Bank would, for middle-income countries such as Chile, phase out its lending activities in the future; the phaseout would enable countries to reduce their net indebtedness to the Bank gradually. Target dates for zero net indebtedness would presumably range from 15 to 30 years, depending on the individual countries. At the same time, the Bank's role in poor countries would be considerably more oriented toward those where appropriate policies were in place, and those where Bank support could induce significantly more rapid policy reform.

Such a role would be considerably reduced from that which the Bank currently plays. It would become more of a "niche" player, supplementing private markets.[83] Nonetheless, its experience with development project lending and with support for sectoral and structural policy reforms would enable it to play a major role in the international economy.

The alternative to this approach, and the one the Bank seems to be taking,[84] would maintain a lending role for the Bank in all its client countries. For middle-income countries, much of the new lending would be in support of those issues, such as women's rights, labor standards, health and safety issues, and environmental protection, where the private market (and local governments) are not deemed to be allocating sufficient resources.

There are serious dangers with this approach. Insofar as national governments in middle-income countries are themselves unwilling to allocate sufficient resources to these "soft issues," the question arises as to why an IFI should provide financing. There is also a major danger of the Bank's embracing a wide variety of issues with little common focus, and being "all things to all people."

Many of the accusations about the

[82] Such differentiation would require both that the Bank staff are able to distinguish among those claiming support and that there be no political interference by the large industrialized countries with lending decisions. To the extent that the Bank has somewhat more independence than do bilateral aid agencies, there is a basis for believing that the second criterion may be better met internationally.

[83] An interesting, and seldom discussed, issue is how the regional development banks, and particularly the InterAmerican Development Bank, would function were the World Bank to focus its activities along the above lines.

[84] See, for example, the speech by Robert Picciotto (1997) in which he stated "Jim Wolfensohn and his entire management team are utterly committed to realizing the vision of a 'sunrise Bank'. This vision is linked to a wholly different conception of the Bank's role: whereas Lew Preston and his closest collaborators saw the Bank's main product as lending to developing countries, Jim Wolfensohn is committed to a Bank that will provide a diverse range of services to the entire development community." See also James Wolfensohn (1997).

Bank's organizational ineffectiveness may originate from its efforts to extend into all directions in all countries. A strong case can be made that, in getting as involved as it has with environmental matters, cooperation with NGOs, combating corruption, and embracing other "new issues," the Bank has moved far beyond its essential competence in addressing many of these issues, and in so doing, has overstretched the capacity of its staff.[85]

Moreover, whereas there was and is a reasonably widely accepted paradigm as to the broad ingredients of development policy and ways in which the Bank can support it, there is much less clarity with regard to the proper means to achieve objectives in the new "soft" areas. Shifting attention to these areas is therefore bound to increase controversy as to the Bank's capacities.[86] On balance, the case for the Bank refocusing on development, and shifting its efforts toward its more traditional competencies in that area for poorer countries, seems very strong.

4.3 *The Future Role of the Fund*

For the world as a whole, the Bretton Woods system is no more. The major industrial countries' finance ministers and central bank governors meet when there are key exchange rate or macroeconomic coordination issues among them, and the Fund is not always even party to the discussions. Clearly, the 1940s rationale does not hold.

However, the Fund still fills two roles. The first role pertains to individual "crises" of countries outside the G-7, where private capital flows are not a major factor in these countries' difficulties.[87] The second, and more controversial role, has to do with "crisis" management when large private capital flows are taking place.

Exchange Rate System.[88] For small (and especially low-income developing) countries, there are powerful arguments for the existence of an international body to facilitate stabilization efforts, including adjustments in the exchange rate and/or exchange rate regime. While an additional argument may be made that the presence of a Fund program provides important signals for private creditors, access to the Fund in times of balance-of-payments crises has encouraged many countries to undertake more far-reaching adjustments, or to undertake them sooner, than they otherwise

[85] Until the end of the Cold War, political support for development assistance through the IFIs and bilateral agencies originated from two groups: those on the right concerned with security, and those on the left supporting development objectives on humanitarian grounds. With the end of the Cold War, support from the right eroded and the Bank's efforts to spread itself into new issues may reflect a search for a broader political support base.

[86] A recent example involves the Bank's decision that, in order for countries to qualify for investment guarantees from MIGA (the investment guarantee arm of the Bank) , they must have adequate "labor standards" in place. Since these standards are highly controversial, and often insisted upon by those in developed countries concerned with competition from "low-wage" foreign sources, it is doubtful whether this decision will enhance development prospects.

[87] Even for countries without capital account convertibility, even the availability of short-term trade finance can mean that there are issues of debt rescheduling when a Fund program is undertaken. However, the issue of moral hazard, which features so prominently in discussions of the Mexican crisis of 1994 and the Asian crisis of 1997, does not arise when long-term private capital flows are highly regulated.

[88] Research on exchange rate regimes continues, led by the Fund's research department. Two issues have received great attention in recent years: the role of private capital flows, and especially the pressures those flows can place on individual currencies to appreciate, and the appropriate exchange rate policy to accompany efforts to reduce inflation rates. Use of the exchange rate as a "nominal anchor" has been frequent, and analysis of the effects of this policy is ongoing. See Guillermo Calvo, Carmen Reinhart and Carlos Vegh (1995) for a discussion.

would have.[89] The presence of Fund staff, support, and programs has been important in the economic policy reforms of such countries as Chile, Mexico in the mid-1980s, Korea in the early 1960s, and Turkey in 1980–81. For anyone observing the challenges facing, e.g. Ghana in 1984 or Turkey in 1980–81, the positive impact of individual Fund programs is evident.[90] And, as seen above, efforts to assess Fund programs systematically have provided statistical evidence of their value, especially over the longer term.

While there are several proposals for changes in underlying exchange rate systems, the fact is that there are two prior issues which would have to be agreed upon, and they are not. Morris Goldstein (1995, p. 2) put it well:

> All appraisals conclude that the performance of the world economy could be improved if policy discipline were strengthened and if the frequency and size of exchange rate misalignments could be reduced. But there is little consensus on how to bring that about. Those most convinced of the need for fundamental reform of the system—in the sense of a move to explicit, binding exchange rate targets by the three key-currency countries—are not in a position to do much about it. Those who are in such a position are not convinced of the need for such fundamental reform. Much the same could be said for proposals to give the IMF greater responsibilities in overseeing exchange rate policies and in organizing international economic policy coordination.

Goldstein's own proposals are for the Fund to focus more on avoidance of large exchange rate misalignments, and development of an early warning system to identify them between major currencies. They could be implemented largely by action of the U.S., Japan, and the European Union without any structural reforms of existing international institutions.

Analysis of exchange rate regimes without reference to underlying monetary and fiscal policies is intellectually unsatisfactory. Yet the split between the Fund's acknowledged role with respect to exchange rates and its lack of role regarding monetary-fiscal coordination is striking. As long as the largest countries continue to follow flexible exchange rate systems and to discuss macroeconomic coordination in other fora, the IMF will be dealing with issues of macro and exchange rate policy only in the smaller trading nations.[91]

Some have pointed to the Fund's continued presence in a number of countries as signs of failure of its programs. To a degree, this may reflect the willingness of the Fund to support programs which are insufficiently corrective of underlying difficulties, either because of pressure from governments of industrial countries or because the Fund staff may have judged that the program they could negotiate was at least a move in the right direction. But, despite these criticisms, the Fund and its staff have generally been viewed as doing a satisfactory and competent job of dealing with individual countries' difficulties.

From this perspective, criticism of individual Fund programs can legitimately be aimed more at their weak conditionality than at their overly

[89] I ignore issues of moral hazard and "bailout" here. These are addressed below. It can also be argued that private capital markets are irrational, at least in the short term, and that Fund resources can usefully provide a buffer against the vacillations of private capital flows. See Mussa et al. (1994).

[90] To be sure, for every "success," there are failures, and one can question whether alternative Fund programs might not provide even more benefits for the countries involved and the world economy, as the Fund's own reviews, discussed above, clearly show.

[91] See Mussa, Morris Goldstein, Peter B.Clark, Donald J. Mathieson and Tamim Bayoumi (1994) and Eichengreen (1994) for other analyses reaching this conclusion.

restrictive conditions.[92] In part, this "weakness" arises because of political pressures, as was evident with the Argentine loan discussed above. At least in this author's judgment, any recommendations for changes in the Fund's future activities with respect to individual countries should attempt (presumably through persuasion of policy makers in the large industrial countries) to insist upon conditions that offer greater hope for success and to make it more difficult for weak programs to gain support.[93] But that the Fund's programs are generally devised along lines likely to improve macroeconomic and exchange-rate management in low-income countries has not been widely questioned.[94]

4.4 *Crisis Management*

After each major jolt to the international economy, there come calls for changes in the international monetary system and suggestions for reforms, normally through the IMF. In the aftermath of the 1973 oil price increase, the Extended Fund Facility was established. After the 1982 debt crisis, calls were heard for a variety of reforms.[95] After the Mexican crisis in 1994, calls were heard for provision of better and more reliable data in a timely fashion, and for a number of changes in IMF practices.[96]

In all of these discussions, critics of the IMF have included those who believed that specific aspects of an individual country program were in error, as well as those who believed that there are ways in which the Fund's practices are more generally questionable. Proposals for change include calls for changes in individual programs, but these are not covered here.[97] To be sure, on occasion, criticism of a particular program is based on the conviction that many other programs may err in the same direction.[98] However, focus here is on the more general issues that have been raised.

Some have argued that there was a "systemic risk" in the Mexican and the Asian crises, in that the spillovers might have led to a global financial crisis. This was certainly a frequently voiced

[92] This has certainly been the case with respect to lending to Russia, where political pressures on the Fund were assuredly strong. See, for example, Meltzer (1998).

[93] The large industrial countries, especially the United States and northern European countries, have often acted almost as if they were "patrons" in pressing for positive support of countries they wanted supported.

[94] Large private capital flows are mostly an issue for the middle-income countries. When private lenders can extend credit, issues of moral hazard arise with regard to Fund programs. Those are discussed below in connection with crisis management.

[95] These included a number of proposals for debt relief for the heavily-indebted countries. Indeed, by 1989 the Brady Plan was effected, which essentially did that.

[96] For some of the suggestions in the wake of the Mexican crisis, see *New York Times*, June 22, 1995, p. C2 for suggestions for an international bankruptcy court; *Financial Times*, August 15, 1995, (Rory MacMillan) for the establishment of bondholder councils; *Financial Times*, March 26, 1996, p. 4 for calls for more monitoring by the IMF of domestic banks; and the *Economist*, June 10, 1995, pp. 19–21 for a survey of the discussion at that time.

[97] For example, the programs of the four afflicted countries in East and Southeast Asia all called for fiscal tightening; some questioned the need for any fiscal tightening while others believed that the required change was too much. It is difficult to understand, however, when there is a "run" on the currency, how there can be any serious choice but to tighten monetary and fiscal policy in the short run. This is not, however, to assert that the quantitative magnitudes set forth in Fund programs were "correct"; analysis would require a study of each individual situation. See also Meltzer (1998).

[98] Martin Feldstein (1998) has been prominent among those who have criticized the IMF for insisting upon policy changes to address long-term structural problems as a condition for receiving short-term loans from the Fund. The issue that arises, which cannot be addressed here, is whether, in the context of capital mobility, revival from a financial crisis is possible without addressing underlying weaknesses in the banking system.

concern in the debt crisis of the 1980s.[99] While there were also concerns during the peso crisis and in 1997, fear of spillover effects on the rest of the world from these crises do not appear to have played as prominent a role in the 1990s.[100]

There have, however, been three major questions raised, over which discussion (and disagreement) continues. They can usefully be discussed under three headings: 1) in what way or ways do the Mexican, Thai, and South Korean crises differ from those in countries earlier supported by Fund programs? 2) Were these crises a function of "panic and mania" characteristics of irrational international capital markets? 3) Do Fund "bailouts" for countries such as Mexico and Korea give rise to extreme moral hazard?

James Boughton (forthcoming) has addressed the first question systematically. He argues that financial crises of the 1990s differ from earlier episodes (such as Mexico in 1982) or even from current difficulties of countries where private capital is not highly mobile. Mexico in 1982 could announce her inability to continue voluntary debt service, and then take several months to negotiate with private banks and the IMF before resuming payments (thus, incidentally, giving the private banks an incentive to negotiate a settlement relatively quickly). But, according to Boughton, a financial crisis is

> a sudden and catastrophic loss of net international assets that makes continuation of the existing policy regime impossible. In any real world case the existing regime almost certainly has flaws that would have to be fixed eventually, but what makes a financial crisis is that those flaws would not have posed an imminent threat to macroeconomic viability without a major shift in the willingness of investors to hold the country's assets and liabilities. (Boughton, p. 3)

This differentiation seems appropriate, although it should be recalled that earlier crises (such as that with the British pound in 1967, and the European monetary crises of 1992) also entailed a run-down of assets (see Krueger 1998). On this definition, it is clearly increased capital mobility which has led to the changed order of magnitude of the "crises" and the urgent need for rapid policy response.

This immediately leads to the second question, the role of private capital flows and capital mobility. Some (including Boughton) believe that holders of assets in the crisis country are or may be on some occasions clearly irrational. On that interpretation, there are several alternatives. One, endorsed by Jagdish Bhagwati (1998) among others, is to restrict capital flows. George Soros (1997) has called for an international credit insurance corporation which would establish borrowing ceilings for individual countries, charging a modest fee to lenders and guaranteeing the loans. Soros does not address issues that might arise with respect to the fungibility of capital, the incentives of individual borrowers to over borrow, or how the corporation would establish credit ceilings. There has also been interest in the Chilean plan under which 30 percent of money entering the country must be held by the Central Bank for one year with no interest. (See Eichengreen and Portes 1995 for further discussion of these issues.)

Others, including Boughton (forthcoming) and Stanley Fischer (1998)

[99] William Cline (1995, p. 14) cites "avoiding collapse of the international banking and financial systems" as one of the three goals of the debt strategy of the 1980s.

[100] But see the quote from Michel Camdessus in Boughton (1998, p.5) where the managing director of the IMF stated that "we . . . had the responsibility. . . to respond to the systemic implications of the Mexican crisis and to give confidence to the international financial system . . ."

recognize the problems, but believe that there is little scope for restriction of capital flows over the longer term. Fischer argues that the Fund's effort to begin assisting with liberalization of capital flows in individual countries could enable a phased sequencing of macroeconomic reforms and capital market liberalization that would mitigate problems.

More severe criticism has come in relation to the last issue. There are three concerns. On one side, the absence of any international equivalent of domestic bankruptcy is noted. Sachs and others have shown that, absent such a mechanism, debtors may undertake less servicing on their debt, and be less well off, than if mechanisms for partial or total bankruptcy-equivalents are available.[101]

Sachs has argued that coordination problems among individual lenders can prevent the achievement of the better outcome without an international institution to orchestrate it, and has proposed that the IMF be empowered to begin serving the lender of last resort function.

Such a proposal encounters the immediate criticism that national politicians who are aware that they will be "bailed out" will be even less reluctant to incur fiscal imbalances than under existing conditions, while foreign creditors will not scrutinize the riskiness of individual borrowing countries to the extent they would were the risks not covered by the IMF.

That criticism is also made vis-a-vis the Fund and its programs. From the viewpoint of the debtors, this argument is of doubtful validity. It is questionable whether politicians and policy makers in debtor countries where crises occur are really immune from penalties, as any witness of the Mexican recession of 1995 will attest. On the other hand, it may be argued that politicians' time horizons are so short that longer-term penalties are anyway unimportant.

The more serious questions arise with respect to the lenders to developing countries. It seems plausible that, especially after Mexico, bankers came to believe that the IMF would always bail them out and therefore they did not feel the need to concern themselves greatly with individual countries' economic policies. And, as contrasted with holders of equity or bonds, commercial banks do seem to have emerged with few losses.

There is fairly widespread agreement on the moral hazard argument as it pertains to international commercial banks, but there is as yet less consensus as to ways to mitigate it. A number of proposals have been put forth. At one extreme are those who cry for the elimination of the Fund, on the ground that it has induced the crises by creating moral hazard (see, for example, Meltzer 1995). There are also suggestions (although not, as yet, plans) for finding ways to force the banks to take more of a hit in the case of an IMF rescue.

No proposal has yet been formulated in a manner to satisfy both the objectives of enabling financing when the situation is critical in Sachs' sense and when adequate fiscal and other reforms are undertaken, while simultaneously avoiding increased incentives or reduced penalties for fiscal imbalances.[102]

[101] This can happen because profitable new investments may not be undertaken if the net return (after meeting debt servicing obligations, which should really be regarded as fixed costs) is less than the financing costs. In that circumstance, reduced debt servicing obligations can induce new investments with a greater payback for the creditor and higher real income for the debtor nation. See Sachs (1989).

[102] The IMF has such a mandate, of course, on an ad hoc basis. When the Clinton Administration wanted to put together a $50 billion package for Mexico, it sought and received the support of the IMF, although the Administration pressed for such rapid action that the usual minimal notice to

4.5 *Relationship of the World Bank and IMF*

As the roles of the IFIs have evolved, both have ended up dealing almost exclusively with developing countries and countries in transition. It was seen earlier that issues of overlap came to the fore in the 1980s. Even now, it is a natural suggestion that the two institutions should merge. The Bretton Woods Commission, led by Paul Volcker (Bretton Woods Commission 1994) considered this proposal seriously. Recognizing the effectiveness of the IMF as an organization, the Bretton Woods Commission thought a merger might provide stronger policy support for those countries where it is needed, and simultaneously resolve some of the organizational problems of the Bank. The Commission rejected the recommendation, however, on the grounds that the short-term macroeconomic issues with which the Fund deals are distinctively different from the project lending and macroeconomic character of the Bank's focus. The Bretton Woods Commission did recommend a number of changes (discussed below) that would result in a much clearer demarcation of the roles of the two institutions.

The proposal that the Bank focus on low-income countries, confining its role to project lending except during periods of intense policy reform, would do much to reduce overlap.

And, aside from the inherent difference between the macroeconomic role of the Bank and the macro role of the Fund, the arguments put forth by Frei (1997) and noted earlier provide another argument for the continued independence of the IFIs; that is, competition between public organizations is one of the mechanisms for keeping them in check. And, historically, at times when the Fund has appeared weak or ineffective, the Bank has been strong, and vice versa. It may be that competition between the institutions keeps both healthier than they would otherwise be.[103]

5. *Conclusion*

The early years of development efforts after the Second World War were characterized by a number of misperceptions as to the appropriate set of economic policies to foster development. The World Bank and the IMF played important roles in the early postwar years in several ways. First, although in hindsight they condoned policies that were not fully consistent with the objective of rapid growth, the comparative perspectives achieved, the research results transmitted, and the policy advice embedded in lending by the IFIs were almost all aimed in the right direction, even if by modern standards they were not aiming far enough. Moreover, lending itself was constructive not only in enabling more rapid growth of infrastructure, but also in demonstrating standards for procurement, project planning, and contracting procedures, and bringing into play cost-benefit techniques and other tools to enable more effective public expenditure programs.

executive directors (so that they may consult with their governments before voting) was not given, and some European executive directors abstained in protest. At the time of completing this manuscript (summer 1997), the Government of Thailand was reported to be approaching the IMF seeking $20 billion to support its efforts to stabilize the economy.

[103] Merging the IFIs, or any other radical reform, would require the writing of new Articles. Whatever mechanism was chosen to rewrite the Articles of the two institutions would have to be insulated from pressures to politicize the Bank and Fund along the lines of other United Nations agencies. Quite clearly, politicization of staff along nationality lines, moves to one-country one-vote, or a number of other possible changes could render the organizations much less effective.

It is frustrating to many, including especially the staffs of the institutions, that it is not possible to quantify the contributions of the IFIs in their first fifty years. But, as shown, many of the contributions (influencing policy outcomes, providing experience and insight for staff who later become government officials, training programs, dissemination of research results) are intangible, and it is impossible to assess them in a quantitative framework. As to the lending program of the World Bank itself, outside of Africa total lending and/or credits were never a significant fraction of any country's GDP, with 2 percent being a very generous estimate of an upper bound. Even if the real returns on that 2 percent had been well above the returns realizable elsewhere, say 10 percent, that could have accounted for growth of at most 0.2 percent of GDP. Variations among countries in growth rates because of different resource endowments, educational attainments, domestic savings rates, level of infrastructure at independence, resource mis allocation because of inappropriate policies and other factors vary so much that it would be virtually impossible to estimate the impact of Bank lending, not to mention the relative importance of the intangibles.

Those studies that have attempted to assess the effectiveness of policy-based lending at either the Bank or the Fund have also encountered enormous difficulties in specifying the counterfactual and estimating the impact of negative (or positive) external conditions which may have affected the outcome. Nonetheless, most studies show moderately better performance of recipients of IMF programs or Bank SALs once effort is made to account for other variables.

If one examines the history of particular successful developing countries, such as Korea, it is evident that the Bank and the Fund, along with bilateral development agencies (including, in the Korean case especially, USAID) and the Asian Development Bank (once it was established) were all lending and contributing to Korea's development. Even with USAID, whose aid was far larger than the Bank and Fund lending programs combined, however, it is difficult to establish a convincing causal link.[104]

While, with 20–20 hindsight, there is no doubt that early Bank and Fund programs and policies could have contributed even more than they did to the international economy, there is also little doubt that their experience and its dissemination speeded up the learning process. At least in this author's judgment, especially in light of thought and policies at the time, the Bank and Fund contributed to accelerating both the learning process and the adoption of less inappropriate economic policies, as well as to the resources available for development.

But a positive, and even strongly positive, verdict on the institutions' performance over the past fifty years does not prove that their future contribution will be equally productive. In the case of the Fund, there is little doubt that it makes a useful contribution to developing countries in supporting their policy changes in times of balance of payments crises (when capital is not highly mobile). In addition, it is clear that the Fund can play a significant role in crisis management, although a number of issues regarding private capital mobility and the allocation of costs between various lenders and the borrower need resolution.

In the case of the Bank, it is relatively straightforward to make a case

[104] See Krueger, Ruttan, and Michalopoulos (1989, ch. 13) for an attempt to assess the effectiveness of USAID in Korea.

that there are still low-income countries that could benefit greatly from Bank lending and support, but there are questions as to whether the Bank has the capacity to focus on those activities.

In pondering these issues, one striking fact should be borne in mind: the most effective institution over the past half century—judged by world economic performance—was the GATT, which was not even an international organization! The WTO came about, almost without planning, because it was in the interests of the major trading nations to strengthen the organization. Whether there is sufficient perceived need, on the part of the major industrialized countries, for a restructured and focussed Bank, or a merged Bank and Fund, or a reassignment of industrial countries' exchange rate policies to the Fund, is an unanswerable question.

It is more likely that, as in the past, change will come from the IFIs themselves, based on a process of discussion, especially in the policy community, and consensus building. For crisis management, the Fund is seeking to develop support for enlarged resources for that role, and it is likely that changes, in addition to better and more timely reporting of statistics, will eventuate.

The Bank, however, seems to be set on a path aiming at the "soft issues." Whether this will provide a basis on which it can achieve a more effective organization and gain support is an open question. If the arguments of the previous section are broadly acceptable, however, it is important for academic economists and others in the policy and research community to discuss alternatives. Otherwise the danger arises that, at some future point, the current directions of the Bank will be rejected, and politicians will decide its future without a backlog of research and analysis to underpin it.

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